

## **V. FUNDING OPTIONS**

The proposed rail passenger restructuring plan will only be effective if there are adequate, reliable sources of funding for the three types of entities being proposed: the NRPC (the government oversight agency), the Operating Company, and the Infrastructure Company. Potential funding options and issues of each will be discussed separately. The Council is providing funding options for Congressional consideration and debate. Funding is critical to the success of any transportation mode to provide the service demanded by the market place. However, the Council is not making specific recommendations to the Congress concerning the most appropriate financing mechanisms to adopt because, among other reasons, such recommendations would be premature until the institutional structure of rail passenger service is determined.

With a few notable exceptions around the world, rail passenger operations require governmental assistance with long term capital funding and, in many cases, with annual funding to cover operating deficits. For the past 31 years, Amtrak has received approximately \$25 billion in funding to cover its operating cash shortfalls and capital expenditures.

The funding needs of rail passenger service are enormous, and there is no assurance that merely providing federal and state funding grants to the existing Amtrak will result in the types of capital investments which are needed to expand and improve rail passenger service in the United States. The separation of the Northeast Corridor and other corridor infrastructure assets from train operations and government oversight will help ensure that the funds which the federal and state governments provide to Amtrak for selected capital projects are actually spent on the intended projects. However, both the infrastructure and operating companies will need reliable sources of operating and capital funds provided with the right incentives to use the funds efficiently to meet the market demands for rail passenger service.

### **A. FUNDING THE NRPC -- THE GOVERNMENT OVERSIGHT AGENCY**

The NRPC, a government oversight agency, is anticipated to be funded by annual federal appropriations in a manner similar to the way that the Federal Aviation Administration (FAA) and Federal Highway Administration (FHWA) are funded, except that these two government agencies receive appropriated funds from dedicated trust funds while the NRPC will receive appropriated funds from general funds, unless Congress creates a trust fund for rail passenger service. The NRPC is envisioned to have a small staff of approximately 50, excluding staff dedicated to providing insurance and risk management functions. After initial funding of the insurance and risk management staff and administrative functions, the cost of the insurance and risk management staff's salary and administrative costs may be passed on to the operating companies utilizing the insurance and risk management functions as a percentage of the cost of insurance premiums and claims paid.

Appropriated funds will also be needed by the NRPC to fund any labor protection costs, excess railroad retirement costs (which may be advanced to the operating and infrastructure companies which actually are liable for the excess railroad retirement payments), and remaining obligations of Amtrak which mature after the Action Plan is adopted (i.e., FELA claims for employee injuries;

unpaid amounts due to states or for Amtrak's share of joint projects; liability claims to passengers and others for accidents; environmental clean-up costs; payments which may be made under Amtrak loan guarantees, to the extent that the federal government agrees to fund them; etc.).

## **B. FUNDING THE OPERATING COMPANY**

### *1. Corridor Trains*

After an initial transition period, during which all routes may initially receive federal operating subsidies, any operating deficits of regional corridor trains are anticipated to be funded by states and regional compacts of states and other transportation entities affiliated with the state and local governments. The Council recommends increased transportation funding flexibility to allow states to decide how to utilize all available transportation funds.

As discussed previously, most of Amtrak's operating losses historically have been generated by the long-haul, overnight trains. With implementation of recommended operating efficiencies and overhead reduction programs, coupled with better utilization of equipment and crews to generate additional ticket revenues and seat miles of transportation service, the regional corridors are likely to cover their direct operating costs, particularly after the corridors mature and have the levels of ridership projected as mature passenger rail corridors.

Although operating subsidies of corridor trains are anticipated to be funded after an initial transition by state and local governments, the capital requirements of corridor trains are anticipated to be funded by locally controlled, flexible funding as well as other capital investment financing mechanisms discussed in greater detail in the section below on capital funding.

### *2. Long-haul Trains*

The operating company (or, optionally over time, franchisee operating companies) are likely to always need operating subsidies for certain long haul routes due to the inherent costs of providing long haul rail passenger service and due to the market price that can be charged for rail passenger tickets. Since there will be no unfunded mandates, uneconomical, long haul trains will only be retained if the federal government decides to subsidize the operating company (or new, competitively-bid franchisee operators) to provide such long haul services. Theoretically, before the operating company abandons long haul rail passenger routes (or any rail passenger route being considered for discontinuance) such routes could be competitively bid out by the NRPC to private operators offering to operate the services on a contractual basis, with the NRPC selecting franchisee operators based on the most attractive terms offered such as levels of service, implicit governmental operating subsidies, and other social considerations such as mitigation of highway and airport congestion.

Long-haul, intercity rail passenger trains are anticipated to receive federal operating funds under subsidy contracts with the NRPC on a train by train basis provided that Congress funds the specific operating deficits through the NRPC and affirmatively determines that such trains should be run at the subsidy levels specified for the service levels proposed.

The current approach to funding Amtrak rewards inefficiency by basing operating subsidies on the size of Amtrak's operating losses. The greater the operating losses Amtrak incurs, the greater the

funding the government needs to provide. The Council recommends that the Congress change this approach by requiring that funding to the NRPC or any other authorized franchising authority (if the NRPC has authorized contracting out) be based upon performance criteria, such as a percentage of revenue measure or a farebox recovery measure. These performance criteria would be the basis of the federal funding allocation throughout the nation.

It is possible that, when multiple franchising authorities are in operation, more successful authorities may develop surpluses as a result of the national funding formula. In these cases, the franchising authorities would establish additional services or expand present services through competitive franchising arrangements or contracts negotiated with the operating company.

### *3. Capital Funding*

With appropriately set operating subsidies provided by the states for corridor trains and the NRPC (with operating subsidies set as a percentage of ticket revenues collected) for long-haul trains, the operating company or companies should be able to finance equipment debt and leasing costs. However, the actual ownership or leasing of equipment from third parties may more logically reside with a separate NRPC subsidiary (which, in turn, enters into short-term operating leases of its equipment with the actual train operators), states, or regional corridors for a number of reasons.

- Ownership or leasing control of equipment would give the operating company with such control undue advantages in any competitive re-bidding for the service routes or corridors.
- States such as California have historically purchased equipment specifically designed for their service requirements.
- Equipment manufacturers or lessors are more likely to provide equipment at low financing rates to regional corridors or states since such entities are not likely to go out of business, and since the inherent demand for transportation service by local voters will ensure that the equipment is used in revenue service, regardless of the financial condition of the train operating company using the equipment.

Like airlines, with proper operating subsidies, equipment leasing and financing costs incurred by operating companies should be able to be funded out of operations. For routes with high costs structures or low ticket revenues, the federal government and states or regions may choose to subsidize trains providing certain train services which are considered to be essential or desirable. As long as federal, state and/or local subsidies are provided in sufficient amounts to enable marginal routes or trains to cover their full operating costs and, presumably, a reasonable profit to the operating company, economically marginal services may be maintained at the lowest cost to the taxpayers thanks to the competitive bidding by operating companies for the franchises to operate the trains with the subsidies offered.

Stations should be developed and funded by local governments, with multi-modal access to buses, transit, airlines and other modes, as applicable. Existing tax-exempt bonds, municipal investments, and private sector funds from commercial real estate developers should provide sufficient financial resources and credit to develop the stations in many cities. Operating rail carriers will pay rents to use the facilities, which will be funded out of their operating cash flows.

If rail operating companies own and maintain their own equipment, they may need to finance the cost of building and furnishing equipment maintenance facilities along with trucks and other vehicles associated with providing rail operating services. Such financing needs will not be materially large relative to the overall scope of the operations. Such equipment maintenance facilities and equipment supporting train operations can be financed with traditional tax-exempt, private activity bonds, operating and capital leases of equipment, and some of the funding mechanisms described below for development of high speed rail corridors.

## **C. FUNDING RAIL INFRASTRUCTURE**

With proper user fees, the Northeast Corridor infrastructure company should be able to fund its operating costs, but the approximately \$28 billion of capital investment needed by the NEC infrastructure company along with the approximately \$70 billion<sup>34</sup> of investment needed to develop a number of federally-designated high-speed rail corridors in other areas of the country, will need long term capital funding sources providing: (1) at least \$1.5 billion annually over approximately 20 years to just maintain and expand the capacity of the Northeast Corridor; and (2) as much as \$3.5 billion annually for 20 years or more to develop a number of the federally-designated high-speed rail corridors.

Such large amounts of capital funding will require new sources of funding from federal and state sources. A number of alternative sources of capital investment financing have been proposed. The Council identifies these options as alternatives for the Congress to consider, but makes no specific recommendations other than certain policy guidelines summarized below.

- Financing mechanisms should facilitate federal-state partnerships.
- Financing mechanisms should encourage regional decision-making to the maximum extent possible, and at the lowest level practical, ideally at the state or local levels.
- Mechanisms or financing programs adopted should not encourage political allocations of funding in projects which do not make transportation and economic sense. Accordingly, funding mechanisms which require state or local participation are preferred to options that rely solely on federal financing mechanisms.
- Funding options that encourage flexibility of funding from various sources at the lowest level of decision-making appropriate are encouraged.

### ***1. Current Legislative Proposals***

During the past two years, proposed legislation has been offered in several forms to facilitate rail infrastructure and high-speed rail development projects including, but not limited to, the following

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<sup>34</sup> Amtrak anticipates that states and interstate compacts will fund a significant portion of the approximately \$100 billion capital investment requirements identified over the next 20 years with state funds or financing mechanisms such as tax exempt bonds, tax credit bonds, and other financing mechanisms.

mechanisms, which can be used to begin funding capital projects of both the Northeast Corridor infrastructure and the federally-designated high-speed rail corridors.

- The RIDE-21 (Rail Infrastructure Development and Expansion Act for the 21<sup>st</sup> Century) legislative proposal, H.R. 2950, proposed total federal funding of \$71 billion for high-speed rail investment by (1) allowing the states to issue \$36 billion (\$3.6 billion per year for 10 years) of tax-exempt, high-speed rail infrastructure bonds which would exempt from the tax exempt volume caps contained in Section 146 of the Internal Revenue Code, and (2) increase the amount of funds available in the RRIF Loan Program from \$3.5 billion to \$35 billion, including \$7 billion for short lines, which funds would be available to freight rail as well as passenger rail projects; and (3) reauthorize the Swift Act at \$35 million per year through 2009, allocated \$25 million for corridor planning and \$10 million for technology development and make the \$25 million available for acquisition of rolling stock.
- The High-Speed Rail Investment Act Bond proposals anticipated that bonds would be issued by Amtrak and possibly others which would provide for federal investment tax credits in lieu of cash interest for the 20 year lives of the bonds. These bonds were proposed by S.1900 and H.R. 3700 in the summer of 2000. The proposals would have required state or other matching funds equal to at least 20 percent of the loan principal, which would have gone into an escrow fund to repay the bonds after 20 years.<sup>35</sup>
- Infrastructure and economic stimulus bills introduced in the 107<sup>th</sup> Congress would provide funding for high speed rail include the \$9 billion of high speed bonds in the proposed Economic Security and Recovery Act of 2001 (H.R. 3090 introduced by Representative Thomas) and the \$15 billion of high speed bonds in the proposed "Rebuild America: Financing Infrastructure Renewal and Security for Transportation Act of 2001 (H.R. 3166 introduced by Representative Borski).
- Other emergency bond and grant legislation proposed after the September 11, 2001, terrorist incidents, with Amtrak originally requesting \$3.5 billion, and finally getting approximately \$100 million to be administered by the Federal Railroad Administration to begin addressing life safety projects in the tunnels leading to Penn Station, New York, and \$5 million to Amtrak for additional security costs.

The above bond mechanisms require repayment in some form or other. The high speed rail bonds use a 20 percent or more escrow fund contributed by states and others when the bonds are issued, which escrow fund presumably will grow over time to fully redeem the bonds in 20 years when they mature, with the federal government providing investment tax credits to holders of the bonds in lieu of cash interest. Other bonds rely on user fees to pay both interest and bond principal. The tax credit bonds are very costly to the federal and state taxpayers. A federal funding program providing 80 percent of the funds from appropriated sources as long as the states fund a 20 percent matching amount would be less costly to the taxpayers over the 20 year lives of the bonds than the high speed rail bonds, but the bonds may be preferable from a public policy perspective of having financing

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<sup>35</sup> To ensure that the escrow funds will be adequate to fully redeem the proposed bonds when they mature in 20 years, a number of states determined that initial escrow deposits of approximately 30 percent would be advisable.

decisions made at the lowest level possible since states have to put up funds equal to 20 percent of the face amount of the bonds being issued before the federal investment tax credits are issued.

Proposed legislation to provide significant funding for rail passenger development, other than the \$105 million of emergency funding for security and life safety expenditures after September 11, 2001, has not been passed by both houses of Congress, and is unlikely to be enacted until the re-authorization of Amtrak, or its successor, is completed.

## ***2. Financing Northeast Corridor And Other Infrastructure***

NEC ownership and maintenance places an unreasonably large financial burden on Amtrak. This burden is not reasonable because Amtrak is the minority user of the corridor, and is not in a position to access or provide the capital resources necessary for the Northeast Corridor. Indeed, the NEC clearly should be owned and controlled by those who operate the dominant and economically vital commuter and freight traffic on the corridor. Once the NEC infrastructure is separated from Amtrak, the result will be an immediate and positive major impact on Amtrak's bottom line profitability and a significant reduction in Amtrak's capital funding requirements.

Amtrak's status as the minority user is evident from the fact that only a small fraction of the massive long-term funding needs of the NEC infrastructure are related uniquely to Amtrak's higher speed passenger operating requirements. In its 20-year plan for capital requirements of the south end of the NEC, issued early in 2000, Amtrak identified only about \$700 million of the \$12 billion in total funding needs as related directly to its new high-speed service. The preponderance of the remaining needs are for conventional intercity passenger, commuter and freight railroad service.

If an original expectation of transferring the NEC infrastructure to Amtrak in 1976 was that it would provide a pipeline to the US Treasury for capital, that expectation has simply not been the case. Further, Amtrak's ability to access additional federal appropriations for the NEC's maintenance and infrastructure requirements have been minimized by recent changes in federal transportation policy. Thus today, there is not any obvious single source, particularly any single federal source, for funding the NEC infrastructure's investment needs. It is important to note, however, that Massachusetts, Connecticut, and New York, the three Northeast Corridor states that own all or part of the NEC spine in their states, have managed to find funding for maintaining and improving their portions of the Corridor.

For two basic reasons, it is vitally important that the NEC infrastructure be properly funded. First, it is vital to the economy of the Northeast, particularly its need to maintain its economic competitiveness with other regions of the nation. In no part of the Corridor is this more important than in the highly congested Northern New Jersey-New York-Western Connecticut metropolitan area, where the preponderance of the commuter train operations are conducted, and where the need for additional commuter rail capacity, and the major additional investments to support that traffic, is greatest.

Second, the Council strongly believes that, if Amtrak continues to be burdened by the ownership and maintenance of the Northeast Corridor infrastructure, its ability to secure sufficient funding for its nationwide train operations will be threatened. The Council's assessment is that Amtrak's

ownership of the Northeast Corridor infrastructure has been a lose-lose proposition – bad for Amtrak’s nationwide train operations and bad for the NEC infrastructure.

Because of the importance of funding the NEC infrastructure, the Council retained the assistance of BGL Rail Associates to compile the latest assessments of capital investment requirements and to assess the sources of funding that might be marshaled to finance them. The BGL report emphasized the limitations on federal appropriations and the lack of any single source of funding able to fund the entire needs of the NEC. The report indicated, however, that there were a number of sources that might each make a contribution to the Corridor’s funding needs.

These potential sources, some existing and some proposed, could be applicable not only to the Northeast Corridor, but also, where appropriate, for the development of other high-speed rail corridors as well:

- Expand transit-related contributions from the Mass Transit Account, as is currently done on portions of the NEC owned by New York’s MTA and Connecticut DOT;
- Partnership with the Regional Transmission Organizations (RTOs)<sup>36</sup> in the Northeast and Middle Atlantic regions to assist in funding the \$800 million cost of the new catenary system south of New York;
- Federally guaranteed loans for large (greater than \$100 million) rail projects under the Transportation Infrastructure Finance and Innovation Act of 1998 (TIFIA);
- Federally guaranteed loans for smaller rail projects under the Railroad Rehabilitation and Improvement Financing (RRIF) Program;
- Bond financing, such as the tax credit bond financing proposed in the High Speed Rail Investment Act (S. 250), introduced by Senator Biden, and the tax exempt bond financing proposed in the Rail Infrastructure Development and Expansion Act for the 21<sup>st</sup> Century (RIDE-21)(H.R. 2950), introduced by Representative Young of Alaska.
- The Rail Security Act of 2001 (S. 1550), sponsored by Senators Hollings and McCain, \$1.8 billion to fund security and safety, including Penn Station New York (PSNY) and the Advanced Civil Speed Enforcement System (ACSES).
- Tax incentives or tax-exempt financing for investment in qualified rail projects that might be offered in economic stimulus proposals put forward by the Congress.
- Expanding the flexibility of current surface transportation funds for the funding of economically justified rail projects that would reduce congestion on other modes of passenger transportation. TEA-21 included flexibility provisions that allowed states to

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<sup>36</sup> Regional Transmission Organizations were created by electric utility companies to interconnect their systems of electrical generation plants and transmission facilities. One or more RTOs may be willing to fund much of the cost of the new catenary system south of New York in return for easements giving one or more RTOs the right to use the NEC to run new high voltage transmission lines.

“flex” funds allocated to their states for transportation projects that were their highest priority. Funds eligible for flexing included those in the Surface Transportation Program (STP) and the Congestion Mitigation and Air Quality Improvement program (CMAQ), though federal law does not currently stipulate whether railroad projects would be eligible for the flexible funding;

- Expanding the flexibility of the Airport and Airway Trust Fund has also been suggested, especially in the aftermath of September 11<sup>th</sup>. The purpose of such flexibility would be to invest in rail projects that would substitute rail service in higher-density corridors for short-haul air services that are no longer economic (such as the air link between Chicago and Milwaukee). It could also be used to expand capacity of rail services that provide direct intermodal access to airports, encouraging integrated, through-ticketed multi-modal transportation services to most efficiently serve the transportation needs of region. This source of funding might be useful on the Northeast Corridor in certain markets connecting with airlines at airports such as Baltimore-Washington International and Newark, New Jersey, as well as other airports along the Northeast Corridor and other regional corridors throughout the United States;
- Another source of potential funding for rail bridges over navigable waterways in the Northeast Corridor and other high-speed rail corridors would be as civil works projects carried out by the Army Corps of Engineers, where bridges essential to rail or highway traffic have received such funding. In Maryland alone, bridges over the Susquehanna, the Bush, and the Gunpowder rivers might conceivably qualify; and
- Freight users could possibly contribute to financing of infrastructure capacity that is used by all NEC users.

### ***3. Proposal For Tax Credit Financing Incentives***

Although the Council makes no recommendations in this Action Plan, in response to Congressional requests that funding mechanisms and options be provided by the Council, the following additional financing mechanism favored by certain large freight railroads is offered as an alternative mechanism to encourage rail infrastructure and high-speed corridor development.

The new rail funding mechanism offered for consideration by the Congress is a tax credit for qualified rail investments, possibly fashioned after the federal low income housing tax credits. Federal low income housing tax credits are earned over a 10 year period based on the value of low income housing investment, provided that such housing remains rented to qualifying low income residents. The housing credit is either 4 percent per year for 10 years or 9 percent per year for 10 years, which, on a net present value basis, amounts to either 30 percent or 70 percent, respectively, of the investment in low income housing. The 4 percent low-income housing credits are available to projects that receive tax-exempt or federally supported funding. The 9 percent low-income housing credits are available to projects, which receive no federally supported or subsidized debt financing.

For a possible multiyear rail investment tax credit, the annual percentage, the number of years that the tax credit is earned, and the net present value of the multi-year credit need to be determined by



Congress. The advantage of such a tax credit is it would benefit the freight railroads, which presumably will upgrade their facilities for rail passenger service, but the credit could be designed so that the freight railroads would only get the full financial benefit if the rail facility remained in passenger use for 10 or more years, giving the freight railroads an incentive to provide good passenger service over their lines. Another advantage of such a multi-year tax credit is that it can be administered by states just as the low income housing credits are issued, subject to overall limitations by state which are determined by the federal government.

#### ***4. Conclusion***

Rail passenger projects will only succeed if there is a multi-year, assured funding source, (funded in a way that Congress and the Administration determine) to enable commitments to build multi-year capital investments in new and renovated facilities. Ideally, multi-year facilities would ensure that political pressures to keep unprofitable trains would be minimized.